

**The Program for Ensuring Compliance
With Anti-Money Laundering Reporting
Requirements Should Be Improved**

December 2000

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

December 26, 2000

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

A handwritten signature in black ink that reads "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Program for Ensuring Compliance With
Anti-Money Laundering Reporting Requirements Should Be
Improved

This report presents the results of our review which focused on determining whether Internal Revenue Service (IRS) controls over the Anti-Money Laundering (AML) program Title 31 activities provide reasonable assurance that objectives are achieved.

In summary, we found compliance with AML reporting requirements can be improved by more effective identification, education, and examination of businesses subject to Title 31. Also, management controls need to be strengthened to measure program performance, provide management information, establish oversight of field activity, and ensure field employees receive sufficient training. Without changes, we believe there is a significant risk of undetected noncompliance and increasingly inconsistent program delivery nationwide.

The recent IRS reorganization into new business units may change how the AML program is carried out. We believe the new division needs to establish: (1) oversight responsibility for Title 31, (2) an educational/information package for all identified or potential covered businesses, (3) performance based indicators, and (4) improved tracking of results and field manager accountability. In addition, the new division should commit more field employees to the AML and ensure sufficient training is provided.

Management's response was due on November 24, 2000. As of December 19, 2000, management had not responded to the draft report.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6500 if you have questions, or your staff may call Walter E. Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs), at (770) 936-4590.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Table of Contents

| | |
|---|---------|
| Executive Summary..... | Page i |
| Objective and Scope..... | Page 1 |
| Background | Page 2 |
| Results | Page 5 |
| Program Effectiveness Should Be Improved..... | Page 5 |
| Management Effectiveness Could Be Improved Through Strengthened Oversight and Control Processes..... | Page 9 |
| Conclusion..... | Page 14 |
| Appendix I – Detailed Objective, Scope, and Methodology | Page 15 |
| Appendix II – Major Contributors to This Report..... | Page 17 |
| Appendix III – Report Distribution List..... | Page 18 |

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Executive Summary

The movement of illegally obtained funds through financial institutions to make the funds appear unrelated or untraceable to the illegal activities is commonly called money laundering. To aid in deterring, detecting, and investigating such illegal activities, the Congress enacted the Bank Secrecy Act (BSA).¹ A section of the BSA, referred to as “Title 31,” requires that certain financial institutions keep records of, and provide reports to the government about, large dollar and suspicious financial transactions.

Since 1970, the Treasury Department has delegated to the Commissioner of the Internal Revenue Service (IRS) the responsibility for assuring that businesses which routinely exchange or handle money, but are not banks (called “non-bank financial institutions,” or “non-banks”), comply with the Title 31 reporting requirements. A 1997 study by Coopers & Lybrand LLP (now a part of PriceWaterhouseCoopers) estimated there were about 158,000 of these non-banks, such as money remitters and check cashers, annually handling financial transactions totaling over \$200 billion (the estimates available do not count financial transactions from all covered businesses). The IRS’ Examination Division is responsible for assuring that these non-banks comply with the BSA financial transaction reporting and record keeping requirements, as part of the Examination Anti-Money Laundering (AML) program.² The Treasury Department’s Financial Crimes Enforcement Network (FinCEN) managers, who regulate the government’s anti-money laundering efforts, consider the IRS Examination Division’s non-bank program to be a key component in the government’s effort to combat money laundering.

The overall AML program objective is to deter and detect money laundering by individuals, trades or businesses, and financial institutions under the IRS’ jurisdiction. There are three aspects to the program in regard to the BSA: (1) identify non-banks subject to the law, (2) educate non-banks on their reporting and record keeping responsibilities, and (3) conduct examinations of the non-banks’ compliance with the BSA reporting responsibilities. To achieve this, the IRS devotes considerable field office resources. For 1999, direct labor costs for revenue agents and tax auditors for Title 31

¹ The Bank Secrecy Act of 1970 (BSA), Public Law 91-508, 31 U.S.C. Chapter 53. Title 31 requires “non-banks” to report certain financial transactions. “Non-bank” financial institutions include certain casinos, card clubs, agents of foreign banks, unregulated banks and credit unions, and “money service businesses” (MSB). The term MSB refers to currency dealers or exchangers, check cashers, issuers of travelers’ checks and money orders, sellers or redeemers of travelers’ checks and money orders, and money transmitters.

² The terms “AML” and “AML program” refer, in this audit report, to the portion of the IRS Examination Division’s AML program charged with enforcing the financial transaction reporting requirements of non-bank financial institutions under the Title 31 provisions of the Bank Secrecy Act.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

were \$15.6 million. As of October 1999, 471 employees worked part-time and 169 worked full-time in the AML program.

The objective of this audit was to determine whether the IRS' controls over Examination's AML program Title 31 activities provided reasonable assurance that program objectives would be achieved.

Results

The IRS needs to improve its program for ensuring compliance with AML reporting requirements and improve controls over the program to reasonably ensure the achievement of program objectives. Without changes, we believe there is a significant risk of undetected noncompliance and increasingly inconsistent program delivery nationwide. Treasury Department's FinCEN managers advised us that they are already in the process of working with the IRS to strengthen the program.

Program Effectiveness Should Be Improved

Program improvements need to be made in identifying, educating, and ensuring compliance of non-banks subject to Title 31.

AML Program Accomplishments. In 1999, IRS employees identified 6,697 entities and added them to the inventory of non-banks covered by Title 31. Performance information was not available on the AML program's second aspect, educating businesses covered by Title 31 on their information reporting and record keeping responsibilities, although indications are some education visits were conducted. In 1999, IRS employees conducted 6,745 AML program compliance examinations of non-banks. In addition, the IRS made 14 referrals to the Department of the Treasury's FinCEN of noncompliant Title 31 businesses for assessment of penalties for noncompliance with financial transaction reporting requirements.

Areas for AML Program Improvement. While the IRS activities do provide benefit to the government's AML efforts, significant program improvements are needed.

- **New Identification of Covered Businesses.** Even with the 6,697 newly identified entities, the IRS' efforts fell considerably short of identifying the non-banks covered by the BSA. The IRS should be more effective in identifying new businesses for inclusion in the program. A consultant hired by the Department of the Treasury in 1997 estimated that there were 158,000 non-bank financial institutions (money service businesses). As of September 30, 1999, the IRS had information on only 64,000 (less than 50 percent of the 158,000). Our discussions with IRS employees indicated that the new identification of covered businesses is not considered a priority by at least some of the IRS field offices.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

- **Education of Covered Businesses.** The IRS does not have a process for educating or even informing more than one non-bank at a time about their AML responsibilities. If AML education work proceeds at the current pace, it is unlikely most non-banks will be informed about their AML responsibilities. In addition, the IRS did not know how many entities subject to the law had been educated as to their responsibilities. Beginning in January 2000, the IRS started to capture the number of educational visits. Our discussions with IRS employees indicated that the majority of businesses have not received the intended education.
- **Examinations of Covered Businesses.** In the last 3 years, approximately one-third of the 64,000 identified businesses have received compliance examinations. However, of the estimated 158,000 non-bank money handlers in the country, over 85 percent had no AML program coverage in the past 3 years. In addition, there were significant geographic gaps in examination coverage in three of four districts reviewed.
- **Referrals to the Department of the Treasury's FinCEN.** A fourth work product of the IRS' AML program is referrals to the Department of the Treasury of noncompliant money handlers for possible assessment of penalties. While not a definitive measure of program effectiveness, a cause for concern would be that the number of IRS Title 31 AML program referrals to the Department of the Treasury's FinCEN have decreased in the past 3 years, from 44 in 1997 to 14 in 1999.

Management Effectiveness Could Be Improved Through Strengthened Oversight and Control Processes

Management controls over the IRS' AML program should be strengthened.

- **Performance Indicators.** The IRS has not established performance indicators for any portion of the AML program. Measuring program performance is required by the Government Performance and Results Act (GPRA).³
- **Management Information.** The management information system for the AML program is weak. IRS management, Treasury, and other oversight organizations (such as the General Accounting Office [GAO]) would have difficulty measuring or evaluating the effectiveness of Title 31 activities. For example, until the Treasury Inspector General for Tax Administration (TIGTA) inquired, the IRS did not begin to maintain information on one of the three AML program aspects—the number of entities educated on BSA financial transaction reporting requirements. Information was available on the number of entities identified and the number of BSA compliance examinations conducted. However, the number of BSA compliance examinations

³ Government Performance and Results Act of 1993, Public Law 103-62, 107 Stat. 285.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

reported was questionable, since field offices combined educational statistics with examination statistics. In general, there is no quality control over the data and no assurance the information is updated timely.

- **Oversight of Field Operations.** In the past 8 years, the IRS National Headquarters analysts had not reviewed field office AML program activities. With the current headquarters staffing (two full-time staff), the IRS cannot reasonably ensure that field activities are effectively conducted or that there is consistent application of Title 31 nationwide. Appropriate oversight is critical since the IRS is reorganizing and the traditional oversight role of regional analysts has been eliminated.
- **Training.** Our visits at the IRS offices around the country showed significant gaps in training for field employees. Out of 20 program examiners interviewed, only 5 stated that they had the Basic program training. For example, one compliance officer specifically stated that he/she is unsure of what he/she is supposed to be doing during a BSA compliance examination.

The need for improvement in program effectiveness and the overall weakness in controls increases the risk that the IRS will not achieve AML program objectives (there will be significant undetected noncompliance and there will be increasingly inconsistent application of the non-bank AML program nationwide). It also increases the risk of not being able to evaluate the success of the program as provided by the GPRA. In addition, the absence of effective controls makes it difficult for the IRS to identify and correct program weaknesses or deficiencies.

Making the situation more critical and complex is the current IRS reorganization and the transition to new business units which has eliminated the oversight role of regional analysts.

Summary of Recommendations

We recommend that the IRS establish oversight responsibility for the AML program in the new IRS business units and strengthen that oversight capability, develop and deliver an educational/information package to a much larger number of covered businesses, improve field manager accountability for AML program objectives, establish measurable performance indicators as suggested by GPRA, improve the tracking of results, ensure more full-time employees are assigned in local offices, and ensure AML program examiners nationwide receive sufficient training.

Management's Response: Management's response was due on November 24, 2000. As of December 19, 2000, management had not responded to the draft report.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Objective and Scope

This audit was initiated as part of the Treasury Inspector General for Tax Administration's (TIGTA) Annual Audit Plan.

The objective of this audit was to determine whether the IRS' controls over Examination's AML program Title 31 activities provided reasonable assurance that program objectives would be achieved.

The objective of this audit was to determine whether the Internal Revenue Service's (IRS) controls over Examination's Anti-Money Laundering (AML) program Title 31¹ activities provided reasonable assurance that program objectives would be achieved. The three aspects of the Title 31 program are to identify non-bank financial institutions required to report financial transactions under Title 31, to educate these entities as to their record keeping and reporting responsibilities, and to enforce the reporting requirements by conducting compliance examinations.

A standard part of all TIGTA audits is the evaluation of the internal control structure applicable to the IRS program or process being reviewed. Internal control is a major part of managing an organization. It comprises the plans, methods, and procedures used to meet missions, goals, and objectives and, in doing so, supports performance-based management. The internal control structure for the AML program was evaluated using the standards outlined in the following guidance documents:

- The Federal Managers' Financial Integrity Act of 1982 (FMFIA).²
- The General Accounting Office's (GAO) *Standards of Internal Control in the Federal Government*.

¹ The terms "AML" and "AML program" refer, in this audit report, to the portion of the IRS Examination Division's AML program charged with enforcing the financial transaction reporting requirements of non-bank financial institutions under the Title 31 provisions of the Bank Secrecy Act.

² Federal Managers' Financial Integrity Act of 1982, Public Law 97-255, 96 Stat. 814.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

- Office of Management and Budget (OMB) Circular No. A-123, Revised, Management Accountability and Control.
- The Internal Revenue Manual, Management Controls Handbook, Document 9515.

We evaluated the national program management controls and how those controls are provided to and administered within local field offices. We conducted our fieldwork in the National Headquarters and at the following District Examination offices: Manhattan, New England, Northern California, and South Florida during the period December 1999 to April 2000. This audit was performed in accordance with *Government Auditing Standards*. Details of our audit objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

Background

Financial system crimes involve billions of dollars and include trade fraud and tax evasion subject to the money laundering statutes.

Financial system crimes, including money laundering, involve billions of dollars of illegal activity. The movement of illegally obtained funds through financial institutions to make the funds appear unrelated or untraceable to the illegal activities is commonly called money laundering. It extends far beyond hiding narcotic profits, as it includes trade fraud and tax evasion subject to the money laundering statutes.

To aid in deterring, detecting, and investigating such illegal activities, the Congress enacted the Bank Secrecy Act (BSA).³ The BSA Title 31 is the core of the Department of the Treasury's program to combat money laundering.

³ The Bank Secrecy Act of 1970 (BSA), Pub. L. No. 91-508, 31 U.S.C. Chapter 53. Title 31 requires "non-banks" to report certain financial transactions. "Non-bank" financial institutions include certain casinos, card clubs, agents of foreign banks, unregulated banks and credit unions, and "money service businesses" (MSB).

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

MSBs handle an estimated \$200 billion in transactions from over 158,000 business locations.

Most Money Service Businesses (MSBs)⁴ are required to report all cash transactions of more than \$10,000 and keep records of transactions of \$3,000 or more. A 1997 consultant study by Coopers & Lybrand LLP (now a part of PriceWaterhouseCoopers) estimated that MSBs handle transactions of \$200 billion per year from over 158,000 locations conducting business (the estimates available do not count financial transactions from all covered businesses). But compared with heavily regulated and monitored banks, the Congress has found that MSBs are largely unregulated and are frequently used in sophisticated schemes to transfer large amounts of money that are the proceeds of unlawful enterprises and to evade requirements of the Bank Secrecy Act, the Internal Revenue Code of 1986, and other laws of the United States.

When BSA violations are discovered, a referral to the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) or to the IRS Criminal Investigation Division (CID) may result. For example, a recent IRS referral to the Department of the Treasury concerned failure to file Currency Transaction Reports (CTRs) for a 12-month period for currency transactions in excess of \$10,000 and failure to keep certain records of those transactions as required by Title 31. The entity attempted to hide bank accounts from the examiner. The entity cashed large checks without filing CTRs and then deposited the cashed checks into accounts. In the contemplated action, the Department of the Treasury may seek penalties of \$25,000 or more per reporting violation and other relief. (The IRS does not have penalty authority.) Also, civil money penalties of up to \$1,000 per violation of the BSA's record keeping provisions are possible.

⁴ The term MSB refers to currency dealers or exchangers, check cashers, issuers of travelers' checks and money orders, sellers or redeemers of travelers' checks and money orders, and money transmitters.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Another example involved executives, along with other employees and associates, of a check cashing enterprise who were indicted for money laundering and evading currency reporting requirements. In total, it is alleged the defendants laundered over \$3.2 million of “drug” money.

Since 1970, the Treasury Department has delegated to the Commissioner of the IRS the responsibility for assuring that businesses which routinely exchange or handle money but are not banks (called “non-bank financial institutions,” or “non-banks”) comply with the Title 31 reporting requirements. The IRS’ Examination Division is responsible for assuring that these non-banks comply with the BSA financial transaction reporting and record keeping requirements (as part of the Examination AML program⁵). The Treasury Department’s FinCEN managers, who regulate the government’s anti-money laundering efforts, consider the IRS Examination Division’s non-bank program to be a key component in the government’s effort to combat money laundering.

This audit focused on the Title 31 side of the AML Compliance program that the IRS’ Examination Division carries out.

The IRS’ Examination Division conducts an AML Compliance program that includes both Title 31 and Title 26, Internal Revenue Code 6050I, Returns Relating to Cash Received in a Trade or Business. Both programs are closely related since the laws deal with reporting of large currency transactions. This audit focused on Title 31 activities.

For 1999, labor costs of revenue agents, compliance officers, and tax auditors for Title 31 were \$15.6 million. An October 1999 staff survey showed 471 part-time and 169 full-time employees worked in the AML program. Each district carries out Examination activities and focuses on identification, education, and enforcement initiatives for Title 31.

⁵ The terms “AML” and “AML program” refer, in this audit report, to the portion of the IRS Examination Division’s Anti-Money Laundering program charged with enforcing the financial transaction reporting requirements of non-bank financial institutions under the Title 31 provisions of the Bank Secrecy Act.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Violations identified by the IRS can be referred to the Department of the Treasury FinCEN and the IRS CID for administrative civil enforcement action.

Results

The IRS needs to improve its program for ensuring compliance with AML reporting requirements and improve controls over the program in order to reasonably ensure the achievement of program objectives. The Treasury Department's FinCEN is in the process of working with the IRS to improve the program.

Program Effectiveness Should Be Improved

Program improvements need to be made in achieving the program's three aspects. The three aspects include identifying non-banks subject to Title 31, educating non-banks as to their reporting and record keeping responsibilities, and ensuring sufficient compliance examinations are being made.

AML Program Accomplishments In 1999, IRS employees identified 6,697 businesses and added them to the non-bank financial institution database inventory. Performance information was not available on the program's second aspect, educating businesses covered by Title 31 on their information reporting and record keeping responsibilities, although indications are some education visits were conducted. In 1999, IRS employees conducted 6,745 BSA compliance examinations of non-banks. In addition, the IRS made 14 referrals to the Department of the Treasury of noncompliant Title 31 businesses for assessment of penalties for noncompliance with financial transaction reporting requirements. While these activities benefit the government's AML efforts, significant program improvements need to be made in achieving the program's three aspects.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Although the IRS NBFI database contains about 64,000 entities, there are about 94,000 other entities not yet identified by the IRS.

New Identification of Covered Businesses The non-bank financial institution (NBFI)⁶ database contains about 64,000 NBFIs. A 1997 study by Coopers & Lybrand LLP (now a part of PriceWaterhouseCoopers) for the Department of the Treasury estimated there were about 158,000 such entities.

Many entities required to report and keep records under the Title 31 AML program are not identified on the IRS database of non-bank financial institutions. As of September 30, 1999, the IRS had included in its universe of covered institutions only 64,000 (less than 50 percent of the 158,000). The primary reasons for the lack of identification are the continuous growth in entities subject to BSA reporting requirements, a decline in staffing and other resources, and a low priority given to identification. There are about 94,000 entities that have not been identified by the IRS.

Education of Covered Businesses Education is a critical part of the AML program's compliance activities to inform the non-banks management and employees of the reporting and record keeping requirements of the BSA. Education includes advice on filing timely, complete, and accurate CTRs and recognizing potential "structuring."⁷ When education of a covered business is conducted, it is usually concurrent with an examination and is on a one-on-one personal visit basis. While this method should ensure the quality of educational visits, it severely limits the number of educational sessions possible.

⁶ The NBFI District inventory of financial institutions, known as non-banks, is maintained and updated by the Title 31 Coordinator on the NBFI database which is located at the Detroit Computing Center.

⁷ Structuring is a series of related transactions that could have been conducted as one transaction but is intentionally broken into several transactions for the purpose of circumventing the reporting requirements of Title 31.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

The IRS was unable to determine how many entities have been educated about their BSA reporting responsibilities.

At the beginning of our audit, management was unable to determine how many educational visits the field AML program examiners had made to assist and educate entities to comply with the law. However, in January 2000 the IRS began to capture the number of educational visits made on its management information system. Our contacts with the IRS field examiners indicated that the majority of businesses have not received education.

It is very likely the current method of one-on-one education will never reach the majority of entities. With a major registration of businesses planned in the near future due to new Treasury regulations, the probability is that the IRS will have even more businesses needing education about their BSA reporting responsibilities.

In the last 3 years, about one-third of identified businesses have received compliance examinations.

Examinations of Covered Businesses In the last 3 years, only about one-third of identified non-bank financial institutions have received examinations. IRS records show that 20,838 examinations were made on the approximate 64,000 non-banks known to the IRS. However, of the estimated 158,000 non-banks, over 85 percent have had no coverage in the past 3 years. Further, the number of examinations reported may be inaccurate, since we found that some local offices counted educational visits in the category of examinations in their quarterly reports.

Also, there are indications, as illustrated by the following table, that in some local offices, much AML program work in recent periods involved educational visits and very few compliance examinations.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Percentage of Non-Banks Subjected to Compliance Examinations in Fiscal Year 1999

| Office | Number of Non-Banks | Number of Compliance Exams Conducted | Percentage of Non-Banks Examined |
|--------|---------------------|--------------------------------------|----------------------------------|
| # 1 | 4,200 | 854 | 20% |
| #2 | 1,263 | 45 | 04% |
| #3 | 869 | 55 | 06% |

Source of Data: IRS Examination Division Field Offices

Money launderers will operate where they know their chances for evading regulatory efforts are the highest.

In addition, certain geographical areas are not being covered, some for long periods, making them more vulnerable to undetected improper activity. Criminals may discover that enforcement coverage is weak and take advantage of the situation. Money launderers may move their operations to financial institutions or areas in which their chances of avoiding detection are the highest.

For example, at one large district, there was no assignment of staff to cover a large part of the state after a trained agent left in 1998. An IRS manager advised TIGTA auditors that this local office had much potential for money laundering activity.

Referrals to the Department of the Treasury's FinCEN A fourth work product of the IRS non-bank program is referrals to the Department of the Treasury of noncompliant money handlers for possible assessment of penalties. While not a definitive measure of program effectiveness, the number of Title 31 cases the IRS has referred to the Department of the Treasury for penalty assessment has dropped in the past 3 years, from 44 in 1997 to 14 in 1999.

The IRS does not hold local managers responsible for achieving program objectives.

The primary reason for weaknesses relating to identifying non-banks subject to Title 31, educating them on their responsibilities, and ensuring sufficient compliance examinations are made is that the IRS has not placed responsibility for achieving AML program non-bank reporting objectives at the local manager level.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Instead of being focused on program outcomes and objectives, local Examination managers were focused on delivering the number of program staff hours (full-time equivalents) shown in a plan.

Without changes, we believe there is a significant risk of undetected noncompliance and increasingly inconsistent program delivery nationwide.

Recommendations

The IRS Small Business/Self-Employed Division should:

1. Establish AML program and Title 31 oversight responsibility for the field Title 31 operations in the new business units.

Management's Response: Management's response was due on November 24, 2000. As of December 19, 2000, management had not responded to the draft report.

2. Expand significantly the information available to covered businesses on their BSA reporting responsibilities by developing and delivering, via creative methods (mailout, Internet, industry associations, etc.), a concise education/information package to all identified or potential BSA reporting entities.

Management Effectiveness Could Be Improved Through Strengthened Oversight and Control Processes

Management controls over the IRS' non-bank AML program are weak in several areas, making program evaluation; quality control; and effective, consistent program delivery more difficult.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Performance Indicators The Government Performance and Results Act of 1993 (GPRA)⁸ requires agencies to set annual performance goals and measure and report on performance toward those goals. IRS guidelines state in part that, to the extent practicable, objectives and goals should be expressed in measurable or quantifiable terms. Also, GAO *Standards for Internal Control* state that there should be top-level reviews of actual performance and establishment and review of performance measures and indicators.

The IRS has not established performance indicators for the AML program, so it is not currently possible to objectively measure performance. For instance, the field offices we visited had no workload or performance goals.

The absence of performance data makes it more difficult for IRS Examination management and the Department of the Treasury to determine how effective a job the IRS is doing in the Title 31 program.

The quality and timeliness of management reporting of program activities should be improved.

Management Information The management information system for the AML program was not comprehensive. IRS management, Treasury, and other oversight organizations (such as the GAO) would have difficulty measuring or evaluating the effectiveness of Title 31 activities. For example, until TIGTA's inquiry, the IRS did not begin to maintain information on one of the three program aspects—the number of entities educated on BSA financial transaction reporting requirements.

Information was available on the number of entities identified and the number of BSA compliance examinations conducted. Some field offices combined educational statistics with examination statistics. In addition, the information available on how many institutions received BSA compliance examinations was not always updated for extended periods.

⁸ Government Performance and Results Act of 1993, Public Law 103-62, 107 Stat. 285.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

The quarterly reports that the field offices submit to the National Headquarters are the management information system for the program. Generally, there is no quality control over the data and no assurance the information is updated timely.

Oversight of Field Operations National Headquarters oversight of the effectiveness of field AML program activities has been minimal. This condition increases in significance now that the traditional oversight role of regional offices has been eliminated.

Operational reviews of field AML program activities have not been routinely conducted.

- Operational reviews of field AML program activities have not been routinely conducted. The National Headquarters staff has declined from 12 people in 1993 to 2 in 2000, which affects their ability to manage and oversee execution of field AML program activities. National Headquarters employees have not made field oversight visits for 8 years.
- Operational oversight of field AML program operations was performed by IRS analysts from local regional offices. The IRS regions are in the process of being eliminated by October 1, 2000. As of the end of our audit fieldwork, the reorganization design plans for transitioning the regional AML program oversight has not been formed so the responsibility for oversight is unknown. According to one regional analyst we contacted, no AML program field monitoring visitations had been made by their office in the last 3 years. Without some type of monitoring, the IRS cannot reasonably ensure that field activities are effectively conducted or that there is consistent application of Title 31 nationwide.

Training Visits to IRS offices around the country showed significant gaps in training for field employees. Assigned examiners need specialized skills and training to recognize violations of BSA reporting requirements. However, many examiners are sent to the field without receiving the 2-week Basic AML program class or casino training. For example, of the 20 field AML

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

A number of AML program examiners advised TIGTA that training received has not been adequate, and some examiners were unsure about what they are supposed to do.

program compliance officers we interviewed, only 5 had received the Basic AML program training course.

A number of examiners in the field advised TIGTA that training has not been adequate, and some examiners were unsure about what they are supposed to do on an AML program examination. For instance, a compliance officer who has worked in the AML program since October 1996 stated she did not know if a bank deposit analysis was being performed correctly or incorrectly. In addition, another compliance officer specifically stated that she is unsure of what she is supposed to be doing during a compliance examination. Field officials involved cited limited training funds as a reason for training shortfalls.

FMFIA, OMB, Treasury, GAO, and IRS guidelines provide that managers should establish and maintain systems of management control that provide reasonable assurance that programs achieve their intended results.

Contributing Factors

Title 31 AML program work is perceived as outside the main IRS tax enforcement mission.

There are strong indications that managers in field offices devote minimal attention to the Title 31 AML program. Title 31 work is perceived by many local personnel as being outside the main IRS income tax enforcement mission and, thus, not a desirable area to work in or spend time managing.

The key AML manager is busy with many duties, such as instructing untrained field examiners.

Contributing to the weakness in controls over the AML program is the low number of employees (two) available to provide oversight and guidance and to design and implement controls. Also contributing to the weakness in controls is that pertinent managers and the program analyst were not familiar with government-wide or IRS control requirements and guidelines. For example, the key manager over the AML program is kept busy by performing many duties, such as personally providing basic instruction to untrained AML program field examiners, acting as a liaison to the Treasury Department's FinCEN, and working on MSB initiatives. Field officials involved also cited limited training funds as a reason for training shortfalls.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Effect of Control Weaknesses

These overall control weaknesses increase the risk that the IRS will not achieve AML program objectives and make program evaluation; quality control; and effective, consistent program delivery more difficult. Control weaknesses also increase the risk of inefficient, wasteful, or improper activities.

Weak controls make it difficult to ensure consistent program delivery. As a result, we noted significant differences in AML program enforcement priorities between offices.

For example, there are inconsistencies in local office execution of the three main aspects of the IRS AML program. In one local office, emphasis is given to BSA non-bank education and identification, but virtually none to compliance examinations. Another IRS office accomplished almost no new identification of non-participating businesses, but emphasized conducting compliance examinations of non-banks. In other locations, significant geographic segments received no AML program coverage at all. These inconsistencies provide inviting targets for those interested in hiding their fraud-related financial transactions.

Finally, this situation is made more critical and complex due to the current IRS reorganization, the accompanying transition to new business units, and the elimination of the historic oversight positions of regional analysts.

Recommendations

The IRS Small Business/Self-Employed Division should:

3. Establish measurable performance-based indicators for Title 31 activities in accordance with GPRA guidance.
4. Improve tracking of productivity and achievement of performance indicators by ensuring reliable Title 31 information is timely provided by field units.
5. Track achievement in the area of education separately if it remains a primary objective.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

6. Assign more analysts to AML program oversight responsibility, ensuring time is allocated to overseeing the Title 31 activities.
7. Ensure managers over field AML program examiners are more accountable for achieving Title 31 objectives, perhaps by ensuring AML program objectives are included in annual performance standards or directing field managers to more closely monitor the effectiveness, quality, and consistency of AML efforts.
8. Ensure more field employees are committed to the AML program and not redirected into telephone answering or other non-compliance efforts.
9. Ensure sufficient training is provided nationwide on a timelier basis.

Conclusion

Ensuring compliance with financial transaction reporting requirements by non-bank financial institutions is an important facet of the government's fight against criminal activities. While the IRS' AML program has made some inroads in this effort, improvements in program achievement and control are needed. Without changes, we believe there is a significant risk of undetected noncompliance and increasingly inconsistent program delivery nationwide.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to determine whether the Internal Revenue Service (IRS) Examination function's internal control system provides reasonable assurance that Examination's Anti-Money Laundering (AML) program achieves its objectives in accordance with federal law and with government-wide management and control standards.

Our review focused on the national program management controls of the National Headquarters Examination function (Compliance Specialization) and how those controls are extended to and executed within local field offices. These controls should ensure that IRS employees executing the AML program effectively and efficiently identify the responsible entities required to file currency transaction reports, educate the entities to comply with anti-money laundering laws, and enforce reporting requirements.

Our audit work consisted of on-site visits to the National Headquarters (to interview key employees and examine records) and to the following IRS Examination offices: Manhattan, New England, South Florida, and Northern California. We conducted inquiries with 20 examiners and compliance officers at these field sites. Also, we held meetings with the Department of the Treasury during the course of the review.

A key part of our review was to evaluate overall program management and controls in light of guidelines from the Federal Managers' Financial Integrity Act (FMFIA),¹ the Government Performance Results Act (GPRA),² Office of Management and Budget Circular A-123, Treasury Directive 40-4, and IRS control and operational guidelines. The following were the specific sub-objectives for this audit.

- I. Determined if IRS Examination nationwide program management controls (including those for measuring the success of the AML program) provide reasonable assurance that the AML program achieves intended results in each of the three major program areas, in compliance with government-wide management and control standards. To achieve this objective we:
 - A. Consolidated the results from objectives II, III, and IV.
 - B. Analyzed the consolidated results and concluded whether IRS controls complied with government-wide management and control standards and

¹ Federal Managers' Financial Integrity Act of 1982, Public Law 97-255, 96 Stat. 814.

² Government Performance and Results Act of 1993, Public Law 103-62, 107 Stat. 285.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

provided reasonable assurance that the AML program achieves intended results.

For objectives II, III, and IV, which follow, tested for effective program management controls in place over each of the three primary AML areas, including such controls as:

- A timely, focused, and well-communicated annual program letter to field offices on the program objective, which sets program goals related directly to applicable federal law.
- An effective method of ensuring that the program letter was being executed in the area of this program objective in all geographic areas of the country.
- Evidence that training was effective and current for employees in the program nationwide.
- Evidence that resources sufficient to achieve the intent of the law were being delivered to the program and that on-site supervision was effective.
- Evidence that quality review of AML work ensured compliance with national guidelines and consistent application of the law nationwide.

Control tests were conducted as needed, once fieldwork was started. Tests were conducted in the National Headquarters and in field offices selected for representing various levels of possible money laundering activity nationwide. Evidence obtained and analyzed consisted of data from the management information system, the consultant study findings, Financial Crimes Enforcement Network documentation, and available records pertaining to budget, staffing, training, and field case work.

- II. Determined if IRS management has set in place sufficient program management controls to reasonably ensure the AML program on a national level and in local field offices effectively identifies responsible entities required to file currency transactions reports in compliance with the law and government-wide management and control standards.
- III. Determined if IRS management has set in place sufficient program management controls to reasonably ensure that IRS field Examination employees effectively educate and assist the responsible entities to both understand their reporting obligations and to voluntarily submit the required currency transaction reports in compliance with the law and government-wide management and control standards.
- IV. Determined if IRS management has set in place sufficient program management controls to reasonably ensure that IRS field Examination employees effectively enforce anti-money laundering reporting provisions in compliance with the law and government-wide management and control standards.

The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Appendix II

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The Program for Ensuring Compliance With Anti-Money Laundering Reporting Requirements Should Be Improved

Appendix III

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